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No. 93-404

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

ARTHUR L. GUSTAFSON, DANIEL R. McLEAN
and FRANCIS I. BUTLER,
Petitioners,

v.

ALLOYD, CO., INC., and
WIND POINT PARTNERS II, L.P.,
Respondents.

On Writ of Certiorari
To The United States Court of Appeals
For The Seventh Circuit

BRIEF OF *AMICUS CURIAE* NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether the private cause of action against sellers of securities created by Section 12(2) of the Securities Act of 1933 is limited to initial public distributions.

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AUTHORITY TO FILE AND POSITION OF AMICUS CURIAE

This brief is filed pursuant to Rule 37.3 of the Rules of this Court. The parties consent letters have been filed with the Clerk of this Court. This brief supports the position of the respondents.

STATEMENT OF INTEREST OF AMICUS CURIAE

The North American Securities Administrators Association, Inc. ("NASAA") serves as the forum where its members, the securities regulators of the fifty states, the District of Columbia, Puerto Rico, the Canadian provinces and territories and the Republic of Mexico ("NASAA Members") work together to protect investors at the grassroots level and to promote fair and open capital markets. NASAA speaks as the collective voice for its Members in forwarding those interests.

The principal interest of NASAA in the present case is to seek uniformity in the interpretation of state and federal securities law provisions that are, for the most part, mirror images of each other. Section 410(a)(2) of the Uniform Securities Act of 1956 (the "Uniform Act"), the language of which is very similar to Section 12(2) of the Securities Act of 1933 (the "1933 Act"), has been consistently interpreted to grant a private cause of action against all sellers who make offers or sales of securities (even in the secondary market) that include an untrue statement of a material fact or a material omission. The federal courts, however, interpreting the language of Section 12(2), are split on this issue; some have extended liability only to initial public offerings and others have held that the liability extends to secondary market transactions.

Recognizing that the states and the SEC have been granted joint regulatory authority over the securities markets in the United States, the state and federal courts should seek to interpret these parallel state and federal securities provisions uniformly. Uniform, or similar interpretations, will send a clear message to the marketplace of what is expected and accepted behavior in the securities markets and will assist regulators in the enforcement of the securities laws. Furthermore, a

uniform interpretation of these parallel provisions will promote judicial economy in the state and federal court systems.

As a strong advocate for the protection of the small investor, NASAA is also concerned that a narrow interpretation of Section 12(2) will place small investors at a disadvantage in the marketplace. The small investor generally does not have the same access to information as do large institutional investors or insiders who may demand informtion from an issuer or a market maker, regardless of whether such information is required to be provided. Therefore, it is important that the civil liability imposed under Section 12(2) be held to extend to all secondary market transactions in order to promote the delivery of accurate information to all who participate in the marketplace, at all entry levels. Moreover, contrary to what some may like us to believe, the extension of civil liability under Section 12(2) to secondary market transactions will not create any undue hardships on persons selling securities to perform extensive due diligence. A broad interpretation of Section 12(2) will merely require that all sellers of securities, based upon their knowledge and circumstances, provide accurate information to purchasers.

As previously stated, NASAA is interested in the promotion of fair and open capital markets. NASAA is filing this brief not only to emphasize to the Court the need for uniform treatment of parallel state and federal laws, but also to encourage the Court to promote good public policy by interpreting Section 12(2) to extend to private resale securities transactions as well as to the public distribution of securities.

SUMMARY OF ARGUMENT

The issue before the Court today is whether Section 12(2) creates a cause of action in favor of a purchaser of securities against any "person" who sells "by means of a prospectus

or oral communication" that contains a material misrepresentation or an omission that renders the statements misleading. To determine the scope of Section 12(2), the Section as a whole must be examined, as well as all of its parts, and only if there is confusion should one look at the legislative history of the Section and the policy considerations.

When one looks at the interplay in Section 12(2) between the defined terms "person" and "prospectus," the scope of the Section becomes clear. Congress' choice of the word "person," rather than "issuer," for the introductory clause to the Section suggests the breadth of the Section's application. The inclusion of the word "prospectus" and its use in the alternative to the phrase "oral communication" further clarifies the application of the Section. Looking at the broad definition of the word "prospectus" in Section 2(10) and the fact that the term "prospectus" in Section 12(2) is linked so closely with the broad phrase "oral communication," a narrow interpretation of the term "prospectus" in Section 12(2) would seem contradictory.

Word games are not necessary. The plain meaning of Section 12(2) states that any person who sells a security using a written document or oral communication that contains a material misstatement or omission shall be liable to the person purchasing the security. The Section does not say "only if the purchaser is purchasing from an issuer directly." The civil liability of the Section must extend to secondary trading activity.

Although the plain wording of the Section is clear, if one chooses to look to the legislative history of Section 12(2), it is hard to imagine that Congress enacted legislation to protect only some purchasers of securities. Section 12(2) needs to have broad application to satisfy Congress' attempt to bring confidence back to the marketplace.

Moreover, in order to promote efficient and effective securities regulation, parallel state and federal securities provisions should be interpreted uniformly. The similarity of the language of Section 12(2) of the 1933 Act and Section 410(a)(2) of the Uniform Act is striking. By interpreting them the same, fairness and judicial economy will exist in the marketplace. If, however, this Court chooses to interpret Section 12(2) differently than the state courts have interpreted Section 410(a)(2), the result will be forum shopping, inconsistent investor protection at the state and federal levels and confusion in the marketplace.

Finally, the extension of Section 12(2) to the trading markets will not have a draconian effect on the current practices of securities firms and analysts. Although the federal courts are not uniformly behind the extension of liability to aftermarket activity under Section 12(2), some federal courts and the state courts currently apply civil liability to the secondary markets under Sections 12(2) of the 1933 Act and 410(a)(2) of the Uniform Act, and a "chilling effect" has not occurred. Moreover, securities firms and their agents are otherwise required to review their communications to the public under the NASD's Rules of Fair Practice .

The only valid interpretation of Section 12(2) extends the civil liability of the Section to all sellers, regardless of their status, who make material misrepresenations or omissions in written or oral communications used in the sale of securities.

ARGUMENT

At issue before the Court today is the scope of the civil liability imposed on sellers of securities under Section 12(2) of the 1933 Act when using a "prospectus or an oral communication" that includes an untrue statement of a material fact or

an omission of a material fact. 15 U.S.C. §77l(2)[1] That a private cause of action exists under Section 12(2) is not disputed by the experts.[2] What has not been resolved, however, is whether liability applies only when untrue statements or omissions are included in a "prospectus" used in the sale of securities in conjunction with a public offering or whether liability exists for private offerings of securities as well.[3] Moreover, this debate has also been framed by arguments that the civil liability of Section 12(2) applies only to issuer offerings and does not apply to secondary offerings.[4] As the Court most likely realizes, these debates are not mutually exclusive.

To settle this debate and determine the intent of Section 12(2), one must closely examine the wording of the Section. Fundamental to the wording of the Section, and key to discovering its intent, is the inclusion of the words "person" and "prospectus," both of which are defined terms under the 1933 Act. The breadth of these definitions and the interplay of these terms in the Section demonstrate Congress' intent to provide extensive civil liability under Section 12(2).

Moreover, in order to fulfill the public policy reasons behind

[1]The text of Section 12(2) is set forth in the Appendix to this brief.

[2]Silverstein, *Seller Liability Under Section 12(2) of the Securities Act of 1933: A Proximate Cause-Substantial Factor Approach Limited by a Duty of Inquiry*, 36 VAND. L. REV. 361 (1983); Peterson, *Recent Developments in Civil Liability Under Section 12(2) of the Securities Act of 1933*,5 HOUS. L. REV. 274 (1967); Rapp, *The Proper Role of Securities Act Section 12(2) as an Aftermarket Remedy for Disclosure Violations*, 47 BUS. LAW. 711 (1992).

[3]Weiss, *The Courts Have it Right: Securities Act Section 12(2) Applies Only to Public Offerings*, 48 BUS. LAW. 1, 4 (1992).

[4]Loss, *Securities Act Section 12(2): A Rebuttal*, 48 BUS. LAW. 47 (1992).

the enactment of the 1933 Act[5], Section 12(2) must be read to impose civil liability on all sellers of securities for material misrepresentations or omissions included in a prospectus or oral communication, whether used in conjunction with a public distribution of newly issued securities or as part of a private resale of securities.

I. CONGRESS' CHOICE OF WORDS FOR THE INTRODUCTORY CLAUSE TO SECTION 12(2) EVIDENCES ITS INTENTION TO EXTEND TO SECONDARY MARKET TRANSACTIONS THE CIVIL LIABILITY IMPOSED UPON SELLERS BY THE SECTION. THE SECTION READS "ANY PERSON (EMPHASIS ADDED) WHO -", NOT ANY ISSUER WHO -.

One need not read far into Section 12(2) before it becomes obvious that Congress intended the Section to have broad application. The Section begins with the introductory clause, "Any person (emphasis added) who -." The choice of the word "person" in the introductory clause to the Section sends a clear signal regarding Congress' intent for the Section and qualifies the remaining language in the Section.

The term "person" is a defined term in the 1933 Act and references both individuals and entities, creating a broad ap-

[5]Although the focus of the 1933 Act is the initial distribution of securities, "[T]he dominant purpose of the Securities Act is to provide information to purchasers of securities." Rapp, *The Proper Role of Securities Act Section 12(2) As an Aftermarket Remedy for Disclosure Violations*, 47 BUS LAW. 711, 720 (1992). As Rapp noted, "[T]he economic tragedies associated with the issuance of worthless securities" in the decade following World War I were '. . . blamed primarily on underwriters and dealers (emphasis added) who abandoned standards of fair and honest dealing, and who made promises of wealth with little or no attempt to provide information to investors essential to estimating the worth of a security.' *Id.* citing from H.R. Rep. No. 85, 73rd Cong., 1st Sess. 5 (1933).

plication for any provision in which it is used. §2(2), 15 U.S.C. §77b(2). The 1933 Act also includes a definition of the term "issuer" which, in pertinent part, reads "every person who issues or proposes to issue any security" §2(4), 15 U.S.C. §77b(4). By including a definitional section in the 1933 Act, Congress meant to give specific and clear meaning to particular terms used in the provisions of the Act, thus clarifying their application. Therefore, the definitional section of the 1933 Act should be referenced when attempting to interpret any provision of the Act and, if a defined term has been included in a provision, the term should be interpreted as defined, "unless the context [of the provision] otherwise requires" (emphasis added). §2, 15 U.S.C. §77b.

If, as the petitioners would like us to believe, Section 12(2) is to apply only to initial public offerings of securities, why would Congress not have selected the word "issuer" instead of "person" for the introductory clause? The use of the term "issuer" would have at least made clear that the Section imposes civil liability only upon sellers who make material misstatements or omissions in conjunction with an initial distribution of securities, whether public or private. Congress used such limiting language in Section 11(b) of the 1933 Act which reads, in pertinent part, "...no person, other than the issuer, shall be liable...." 15 U.S.C. §77k(b). But Congress chose not to so limit the application of Section 12(2).

Moreover, the use of the term "person," as opposed to the term "issuer," is also instructional regarding the meaning of the term "prospectus" included later in the Section. Once again, "unless the context otherwise requires," one should look to the definitional section of the Act for the meaning of terms that have been defined. As set forth in Section 2(10) of the Act, the definition of the term "prospectus" includes such diverse written communications as any "letter,"

"circular" or "prospectus." The reason for the comprehensiveness of this definition becomes evident when it is read in the context of Section 12(2). By using the term "person" to qualify the remainder of Section 12(2), it becomes apparent that the broad definition of the term "prospectus" was meant to extend the application of Section 12(2) to written communications used by individual persons trading securities, as well as written communications used by issuers in the distribution of securities.

II. THE PLAIN MEANING OF THE TERM "PROSPECTUS" SHOULD BE GLEANED FROM ITS DEFINITION AND FROM THE CONTEXT IN WHICH IT IS INCLUDED IN THE ACT.

There is some argument whether the term "prospectus," as included in Section 12(2), should be interpreted consistent with the definition of that same term as set forth by Congress in Section 2(10)[6] of the same Act, or whether the Court should reach beyond the definitional section and apply another more limited meaning to the word "prospectus." Some, who would have Section 12(2) apply only to initial public offerings, appear to believe that the term "prospectus" only refers to a §10(a) or statutory prospectus.[7]

Unless there is a clear reason why a different meaning should be applied, or as the Act states, "unless the context otherwise requires (emphasis added)" the term "prospectus"

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[6]The full text of Section 2(10) is set out in the Appendix to this brief.

[7]*See*, Brief of Amicus Curiae Securities Industry Association, Inc. in Support of Petitioners Alloyd Co., Inc. and Wind Point Partners II, L.P. at 4-9.

should be interpreted as defined.[8] A plain reading of Section 12(2) does not suggest that the term "prospectus," as included therein, requires a different meaning than as defined in Section 2(10). 15 U.S.C. 77b(10). When Section 12(2) is read replacing the term "prospectus" with its definition, the meaning of the Section does not become illogical or confused.

Moreover, *Webster's New World Dictionary* defines the word "require" to mean "to be in need of; to call for as necessary or appropriate; to demand by virtue of a law, regulation, etc." *Id.* (3d College ed. 1988) at 1140. The inclusion of the term "prospectus" in Section 12(2) does not "call for as necessary" a different meaning of prospectus than its definition in Section 2(10). Nor is a different meaning "demanded by virtue of a law, regulation." In fact, traditional rules of draftsmanship and the Act itself, by defining the term "prospectus," demand that the term be interpreted as defined.

Furthermore, unlike the need for this Court in *Ernst & Ernst v. Hochfelder*[9] to turn to contemporary reference works to construe the terms "manipulative or deceptive" and "device or

[8]Section 2 of the 1933 Act sets forth the definitions of certain terms used throughout the Act. As the language of the introductory clause to Section 2 (set out below) demonstrates, deference should be given to these definitions when interpreting those terms as included in the Act, subject to contextual inconsistencies.

Sec. 2. When used in this title [the Securities Act of 1933], unless the context (emphasis added) otherwise requires —

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(10) the term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security. . . "

[9]425 U.S. 185 (1976).

contrivance"[10] as used in Section 10(b) of the Exchange Act of 1934, because those terms are ***not*** defined in the 1934 Act itself, there is no need for this Court to look beyond the 1933 Act to determine what is meant by the term "prospectus."

However, the limiting factor of the word "context" in Section 2 is also at issue. It is clear that the phrase "unless the context (emphasis added) otherwise requires," included as the introductory clause to Section 2, was intended to qualify the use of the definitions included in the Section. The question becomes, what is meant by the word "context?" It has been argued that the sections surrounding Section 12(2) should determine whether the definition of "prospectus" in Section 2 is the appropriate definition for the term as included in Section 12(2).[11] We question the need to go beyond the "context" of the sentence where the term is used, or, at most, the Section, neither of which require a different meaning of the term "prospectus."

Similar to the "context" qualification of Section 2, this Court, in *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303 (1961) referred to the maxim *noscitur a sociis*, meaning that a word is known by the company it keeps.[12] Applying that maxim to the

[10]The Court relied on *Webster's New Int'l Dictionary of the English Language* (2d ed. 1934). *Id.*, at 198-99.

[11]*See*, Brief of Amicus Curiae Securities Industry Association, Inc. in Support of Petitioners Alloyd Co., Inc. and Wind Point Partners II, L.P. at 9-10.

[12]In *Jarecki*, the Court stated "The maxim *noscitur a sociis*, that a word is known by the company it keeps, while not an inescapable rule, is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress." *Id.*, at 307, quoted in *Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682, 687 (3d Cir. 1991). Although the possible number of meanings of the term "prospectus" is very limited, the application of the maxim *noscitur a sociis* to the use of the term in Section 12(2) clarifies that the term "prospectus" means any written communication used in the sale of securities.

independent phrase "by means of a prospectus or oral communication" included in Section 12(2), the words "oral communication" take on significance in determining the meaning of the word "prospectus."

The plain meaning of the phrase "oral communication" is a communication by mouth. The fact that those words are linked in the alternative to the term "prospectus" suggests that the word "prospectus" in Section 12(2) was meant to cover written communications used in the sale of securities. Moreover, neither the word "prospectus" nor the phrase "oral communication" are qualified in Section 12(2), thus leading us to the conclusion that "by means of a prospectus or oral communication" was meant cover all oral and written communications used in the sale of securities. This expansive interpretation of term "prospectus," as included in Section 12(2), is consistent with the broad definition of "prospectus" in Section 2(10), which lists a diverse spectrum of written communication devices, suggesting that the interpretation of the term "prospectus," as included in Sections 2(10) and 12(2) of the 1933 Act, should be one in the same.

III. CONGRESS WAS NOT SO SHORT-SIGHTED SO AS TO LIMIT THE APPLICATION OF THE 1933 ACT SOLELY TO INITIAL PUBLIC OFFERINGS. RATHER, SECTIONS 12 AND 17, AND THEIR APPLICATION TO THE AFTERMARKET, PROVIDED ADVANCE NOTICE OF WHAT WAS ABOUT TO COME.

It has been argued that because Congress adopted the 1933 Act, and thereafter separately adopted the 1934 Act, that Congress had no reason to extend the application of the 1933 Act to aftermarket activity and, instead, limited each Act to deal solely with the initial distribution of securities or with after-

market activity.[13] We know, however, that this is not true. This Court has held that Section 17 of the 1933 Act,[14] 15 U.S.C. §77q, applies to the aftermarket.[15] Why then should we stretch the plain meaning of Section 12(2) of the Act to avoid its application to secondary market activity? We should not.

As noted by Judge Abner J. Midva in *Wachovia Bank & Trust Co. v. National Student Marketing Corp.*, 650 F.2d 342 (D.C. Cir. 1980):

> [O]verlap between the two statutes [1933 and 1934 Acts] is neither 'unusual nor unfortunate.' *United States v. National Securities, Inc.*, 393 U.S. 453, 468 (1969), quoted in *United States v. Naftalin*, 441 U.S. 768, 778 (1979). It is nowhere written that each pronouncement of Congress must be mutually exclusive of every other pronouncement. In the securities field, Congress has dealt with the problems of regulation many times — on both the cosmic and the specific levels. The 1933 and 1934 Acts are meant to be interrelated and interdependent components of a general scheme, and the two should be read together. *See, Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976).

1 A. Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud*, §2, at 226-227 (1992).

Moreover, provisions in the Acts that may appear to overlap, upon a closer look actually serve separate and distinct purposes. For example, the Third Circuit has suggested that

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[13] *See*, Brief of *Amicus Curiae* Securities Association, Inc. in Support of Petitioners Alloyd Co., Inc. and Wind Point Partners II, L.P. at 13.

[14] The text of Section 17 is set forth in the Appendix to this brief.

[15] *United States v. Naftalin*, 441 U.S. 768, 777-78 (1979).

because Rule 10b-5 clearly applies to aftermarket trading and provides for a private right of action, but which also requires a more difficult standard for recovery than Section 12(2), Section 12(2) cannot be interpreted to apply to secondary market transactions or it would render Section 10(b) moot because purchasers would naturally bring suit under the lesser standard of Section 12(2).[16] A telling rebuttal to the Third Circuit's argument is:

> [T]he [Third Circuit] court nevertheless did not adequately address the fact that it may be possible to recover under Section 10(b) and not 12(2), since the former proscribes a wider range of conduct,[17] and the latter is subject to several procedural safeguards (footnote omitted); the possibility that to the extent of any overlap; a cumulation [sic] of remedies may not necessarily be inconsistent with the scheme of the legislation (footnote omitted); the fact that the Congress that adopted Section 12(2) could not have anticipated Rule 10b-5; or the implication of the Section 10(b) remedy and all of its elements being implied rather than express.[18]

Close attention should be given to the fact that Section 10(b), and Rule 10b-5, were not yet enacted or promulgated, let alone available to purchasers of securities, when Congress enacted Section 12(2).[19] It is a peculiar argument that because Rule 10b-5,

[16]*Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682, 692 (3d Cir. 1991).

[17]"Whereas Section 12(2) involves false and misleading statements in a prospectus or oral communication, Section 10(b) proscribes any 'manipulative or deceptive device or contrivance in contravention of SEC rules." H. Bloomenthal, *Securities Law Handbook*, § 14.05, at 14-36 (1933).

[18]*Id.*

[19]Section 10(b) was enacted by Congress as part of the Securities Exchange Act of 1934. 15 U.S.C. § 78j. Rule 10b-5 was adopted by the SEC in 1942. 17 CFR § 240.10b-5.

as it *now* exists, applies to aftermarket activity and requires a more difficult standard for recovery than Section 12(2), that Congress drafted Section 12(2) anticipating Rule 10b-5 and thus limited the application of Section 12(2) to initial distributions of securities so as to not render Rule 10b-5 superfluous.

Furthermore, when many of the legal articles regarding Section 12(2)were written and when many of the court cases were decided, an implied private right of action under Rule 10b-5 was firmly recognized. However, in light of *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 62 U.S.L.W. 4230 (Apr. 19, 1994) and the remarks of Justice Stevens in the dissent,[20] any implied private right of action is now suspect. Therefore, the application of the express private right of action under Section 12(2) becomes even more important as an investor protection mechanism.

Finally, "[T]he legislative history is too inconclusive to warrant disregarding the plain meaning of the language of Section 12(2). The consequence of doing so would have left defrauded investors no remedy in connection with secondary market transactions except for the fortuitous circumstance that Congress adopted Section 10(b) of the Exchange Act, the Commission adopted Rule 10b-5, and courts ultimately implied a private remedy for violations of Rule 10b-5."[21]

[20]Justice Stevens notes that 'the creation of new rights ought to be left to legislatures, not courts.' Musick, Peeler, 508 U.S., at ____ (slip op. at 5); and ". . . we are now properly reluctant to recognize private rights of action without an instruction from Congress. . ." *See Central Bank, at 11.*

[21]*Id.*

IV. PARALLEL FEDERAL AND STATE SECURITIES LAW PROVISIONS SHOULD BE INTERPRETED UNIFORMLY TO ENHANCE THE JOINT FEDERAL AND STATE REGULATORY AUTHORITY OVER THE SECURITIES MARKETS AND TO PROMOTE JUDICIAL ECONOMY.

Both the 1933 Act and the 1934 Act specifically preserve the rights of the states to regulate securities transactions within their own jurisdictions.[22] 15 U.S.C. §§ 77r and 78bb(a). Over 76 years ago, however, the state securities regulators recognized the need to cooperate and coordinate with each other in their regulation of the securities markets due to the national nature of the markets and in an effort to promote efficiency in states' securities regulation and enforcement activities. The state regulators facilitated this coordination through their membership in the North American Securities Administrators Association, Inc.,[23] formerly called the National Association of Securities Administrators. The

[22]Section 18 of the 1933 Act reads: Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security of any person.

Section 28(a) of the 1934 Act, in pertinent part, reads: Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person in so far as it does not conflict with the provisions of this title or the rules and regulations thereunder.

[23]In the United States, the North American Securities Administrators Association, Inc. ("NASAA') has as its members the securities regulators from all fifty states, the District of Columbia and Puerto Rico. Members are represented on various committees of the Association that are charged with developing proposed Statements of Policy to be presented to the membership as model or uniform securities regulations and are later considered by the individual jurisdictions for their implementation. The Association meets twice a year to vote on model Statements of Policy and resolutions presented for adoption.

Uniform Securities Act of 1956, and its adoption or substantial adoption by 41 states and jurisdictions of the United States, is a testament to the progress that has been made to coordinate state securities regulation.[24]

In addition to the coordination effort among the states, it has also been recognized that the state securities regulators and the federal securities regulator, the United States Securities and Exchange Commission (the "SEC"), should cooperate and attempt to coordinate their regulation of the United States securities markets.[25] Section 415 of the Uniform Act reads "This act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal regulation (emphasis added).[26] In addition, Section 420 of the Uniform Act states, in part, that "To encourage uniform interpretation and administration of this act and effective securities regulation and enforcement, the [Administrator] may cooperate with the securities agencies or administrators of one or more states, [and] the Securities and Exchange Commission ..."[27]

Moreover, as was noted in the 1993 SEC Release for the Annual Conference on Uniformity of Securities Laws held prusuant to §19(c) of the 1933 Act:

[24]*See*, Jurisdictions Adopting the Uniform Securities Act, 1 Blue Sky L. Rep. (CCH) ¶5500 (1992).

[25]*See*, § 415 of the Uniform Securities Act (1956), *reprinted in* NASAA REPORTS (CCH) ¶4895 (1987); § 420 of the Uniform Securities Act (1956), *reprinted in* NASAA REPORTS (CCH) ¶4900 (1987) and § 19(c) of the Securities Act of 1933, 15 U.S.C. §77s, Pub. L. 96-477, 94 Stat. 2275 (October 21, 1980).

[26]Uniform Securities Act (1956), *reprinted in* NASAA REPORTS (CCH) ¶ 4895 (1987)

[27]Uniform Securities Act (1956), *reprinted in* NASAA REPORTS (CCH) ¶ 4900 (1987.

The importance of facilitating greater uniformity in securities regulation was endorsed by Congress with the enactment of section 19(c) of the Securities Act in the Small Business Investment Incentive Act of 1980. Section 19(c) authorizes the Commission to cooperate with any association of state securities regulators which can assist in carrying out the declared policy and purpose of section 19(c). The policy of that section is that there should be greater federal and state cooperation in securities matters, including: (1) maximum effectiveness of regulation; (2) maximum uniformity in federal and state standards; (3) minimum interference with the business of capital formation; and (4) a substantial reduction in costs and paperwork to diminish the burdens of raising investment capital, particularly by small business, and a reduction in the costs of the administration of the government programs involved.[28]

In light of this prelude of authority recognizing the need for state and federal coordination regarding the regulation of securities, it becomes apparent that parallel federal and state securities laws should be interpreted uniformly. The language of states' statutes that mimic Section 410(a)(2) of the Uniform Act,[29] which is very similar to Section 12(2) of the 1933 Act, have been consistently interpreted to grant a private cause of action against sellers who make offers or sales of securities in the secondary market by means of any untrue statement of a material fact or a material omission.[30] However, as this Court

[28]Annual Conference on Uniformity of Securities Law, Securities Act Release No. 33-6985 (March 31, 1993) (available from the SEC).

[29]The text of Section 410(a)(2) is set forth in the Appendix to this brief.

[30]*Jenkins v. Jacobs*, [1987-88 Decisions] Blue Sky L. Rep. (CCH) ¶72,644; *Elbel v. Royale Energy Company*, [1991-93 Decisions] Blue Sky L. Rep. (CCH) ¶73,540; *Weft, Inc. v. G.C. Investments Associates*, [1986-87 Decisions] Blue Sky L. Rep. (CCH) ¶72,422.

recognizes, the federal courts, interpreting the language of Section 12(2), are split on this issue; some have extended liability only to initial public offerings and others have held that the liability extends to secondary market transactions.[31]

In an effort to further examine the intent behind the language of these sections, consideration should be given to the official comment to Section 410(a)(2), which, in part, states that "[T]his clause is almost identical to § 12(2) of the Securities Act of 1933," L. Loss, *Commentary on the Uniform Securities Act* at 146 (1958). In addition, the Draftsmen's Commentary to Section 410(a)(2) of the Uniform Act states that "The resemblance [of § 410(a)(2) of the Uniform Act] to § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l(2), will once more make for an interchangeability of federal and state judicial precedence in this very important area." *Id.* at 148.

The draftsmen, however, did recommend that if changes are to be made to Section 410(a)(2), "for clarity's sake", a language change replacing the words "by means of," which may be wrongly interpreted to require reliance by the purchaser, with the phrase "by use of any written or oral communication which contains any untrue statement...," should be considered. *Id.* The similarity of this proposed language to the language of Section 12(2), in light of the official comment to Section 410(a)(2), suggests that the draftsmen of the Uniform Act interpreted the term "prospectus," included in Section 12(2), to refer to any written communication. The draftsmen, however, did not recommend that a language change to Section 410(a)(2) should reference the term "prospectus," because the Uniform Securities Act does not define "prospectus" as is done in the 1933 Act.

[31]See the string citations in *T. Rowe Price New Horizons Fund, Inc. v. Preleta*, 749 F.Supp. 705, 707-08 (D. Md. 1990) (citing many cases both ways).

This point is well made by Bloomenthal in the *Securities Law Handbook* where he suggests that plaintiffs bring their 12(2) claims in state courts as pendent actions and include a claim under the state securities law counterpart.[32] He argues that "the state court may or may not follow *Ballay* on the Section 12(2) issue," but he strongly professes that the state claim will not fall victim to the word games of *Ballay*, although most state statutes follow the Uniform Act, which in this scenario, was modeled after Section 12(2). *Id.* at 14-38 — 14-39.

In light of the argument just made, the Court should also give some consideration to the vast backlog of cases that exist in the court systems today, and should discourage forum shopping and promote judicial economy at both the state and federal court levels, by interpreting Section 12(2) consistent with state court interpretations of the states' securities provisions that are the equivalent to Section 410(a)(2) of the Uniform Act. This would permit state and federal courts to share the burden of resolving cases on this matter and provide consistent outcomes for all investors making claims under these provisions.

A quick perusal of any securities law reporter will evidence that a substantial number of state securities law causes of action are brought as pendent actions in federal court. Thus, an interpretation of Section 12(2) that is different from Section 410(a)(2) of the Uniform Act would be a waste of judicial resources and create unfairness to investors who, most likely, would be forced to bring separate actions in both state courts and federal courts.

[32]H. Bloomenthal, *Securities Law Handbook*, § 14.05 at 14-38 (1993).

V. FAIRNESS AND OTHER CONSIDERATIONS OF GOOD PUBLIC POLICY REQUIRE THAT THE PRIVATE CAUSE OF ACTION CREATED BY SECTION 12(2) EXTEND TO SECONDARY MARKET TRANSACTIONS, WHETHER PUBLIC OR PRIVATE.

It is proper, and important, for this Court to consider public policy considerations when construing terms and provisions included in the 1933 Act.[33] A major policy consideration presented by the issue before the Court today is the question of fairness to investors. The Court must decide if it is good public policy to preclude those investors who purchase securities from someone other than an issuer (emphasis added) by means of a written document or an oral statement that includes an untrue statement of a material fact, or omits to state a material fact, from exercising a private right of action against the seller under Section 12(2).

The court in Wilko highlighted the absurdity of arbitrarily limiting Section 12(2) to initial distributions of securities only:

> Such a construction would frustrate the remedial purposes of the statute and lead to absurd and wholly incongruous results. The rights of a purchaser of securities publicly offered for sale would depend not upon whether fraud in fact was practiced, but upon the status of the vendor. Fraudulent sellers would be placed in two categories: one encompassing those engaged in the distribution of securities; the other, those engaged in trading transactions. Purchasers from sellers of the first category would have the protection and the benefit of the Act while purchasers from sellers of the latter category would not. Nothing

[33]*See, Pinter v. Dahl*, 486 U.S. 622, 653 (1988) (quoting *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 694 n. 7 (1985)).

in the Act reflects a more tender regard for the dishonest trader, nor a purpose to protect only purchasers defrauded by sellers other than traders.[34]

Moreover, by limiting Section 12(2) to initial distributions of securities, the Court would also send an unfortunate message to underwriters of securities offerings, that they are not responsible under Section 12(2) for contributing to the accuracy of the prospectus for use by all investors, which is in direct contradiction to the application of Section 12(1) to brokers and others that solicit purchases of securities as "statutory sellers."[35]

In addition, an argument has been made that applying Section 12(2) to secondary market transactions would have a draconian effect on the current operations of securities firms and securities analysts.[36] This argument is flawed for several reasons. First, although all the federal courts that have addressed this issue have not applied Section 12(2) to secondary market transactions, some have. Assuming the securities industry is aware of these decisions extending civil liability under Section 12(2), there does not appear to be any obvious "chilling effect" currently occurring regarding the operations of the securities firms. Second, despite the split of opinions in the federal courts, the states' courts have applied civil liability under their statutes that mirror Section 410(a)(2) of the Uniform Act to aftermarket trading[37] and, once again, no "chilling effect" appears to have occurred. Finally, securities firms and their agents currently have the same obligation to review and monitor their communications with the public under the National Association of Securities Dealers, Inc. ("NASD") Rules of Fair Practice.[38] Moreover, most states follow NASAA's Statement of Policy on Dishonest or Unethical Business Practices[39] which requires brokerdealers and agents to monitor their distribution of materials used in the conduct of their business.

[34]*Wilko v. Swan*, 127 F. Supp. 55, 59 (S.D.N.Y. 1955).

[35]*Pinter v. Dahl*, 486 U.S. 622, 646 (1988).

[36]*See*, Brief of Amicus Curiae Securities Industry Association, Inc. in Support of Petitioners Alloyd Co., Inc. and Wind Point Partners II, L.P.

[37]*See*, Note 28.

It is perfectly appropriate to require securities professionals to operate fairly in the marketplace with investors who don't have the same level of sophistication, nor the same access to information as those who are licensed and employed to do so. Subjecting securities professionals, as well as all sellers, to the negligence[40] standard of liability under Section 12(2) merely requires sellers to exercise reasonable care, ***under the circumstances***, regarding their communications in the sale of their securities. It stands to reason that securities professionals, insiders and average investors all have access to different types of information. Requiring all sellers to disclose material information or to verify the information included in communications they use in the sale of their securities, based on the information reasonably available to the "seller," is good public policy.

[38]Article III, Section 35, *Communications With the Public*, National Association of Securities Dealers, Inc. Manual — Rules of Fair Practice ¶2195 (1995).

[39]*Dishonest or Unethical Business Practices*, NASAA REPORTS (CCH) ¶1401 (1983); Finding Lists, NASAA REPORTS (CCH) ¶ 6211.

[40]"Negligence is the failure to use such care as a resasonably prudent and careful person would use under similar circumstances; it is the doing of some act which a person of ordinary prudence would not have done under similar circumstances." BLACK'S LAW DICTIONARY at 930-31 (5th ed. 1979) (quoting *Amoco Chemical Corp. v. Hill*, 318 A.2d 614, 617 (Del. Super. 1974)).

CONCLUSION

The Seventh Circuit, along with the First and the Tenth Circuits have it right; Section 12(2) of the 1933 Act is applicable to secondary market transactions. Any other interpretation would suggest that Congress was not concerned about the protection of all investors when it enacted the 1933 Act, but only reacted to the market crash of 1929 by protecting investors in the principal market from erroneous and inadequate disclosures, with no regard to the lack of investor confidence that could result in the aftermarket. We do not believe that Congress was so short-sighted when it enacted the 1933 Act.

Respectfully Submitted

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APPENDIX

Section 12(2) of the 1933 Act, 15 U.S.C. §77l:

Any person who

* * *

(2) offers or sells a security (whether or not exempted by the provisions of section 77c [section 3] of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 2(10) of the Securities Act of 1933, 15 U.S.C. § 77b(10):

The term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security; except that (a) a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of section 10) shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of section 10 at the time of such communication was sent or given to the person whom the communication was made, and (b) a notice, circular, advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus if it states from whom a written prospectus meeting the requirements of section 10 may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the Commission, by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors, and subject to such terms and conditions as may be prescribed therein, may permit.

Section 17 of the 1933 Act, 15 U.S.C. § 77q:

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly -

(1) to employ any device, scheme or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicly to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 77c of this title shall not apply to the provisions of this section.

Section 410(a)(2) of the Uniform Securities Act, NASAA REPORTS (CCH) ¶ 4927:

Any person who

(2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), an who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or the omission

is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, ***.